

**REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF MOTHEO DISTRICT MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2008**

**REPORT ON THE FINANCIAL STATEMENTS**

**Introduction**

1. I was engaged to audit the accompanying financial statements of Motheo District Municipality which comprise the balance sheet as at 30 June 2008, income statement and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes as set out on pages XX to XX.

**Responsibility of the accounting authority for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the entity-specific basis of accounting, as set out in the accounting policy note 1 and in the manner required by the Local Government Municipal Finance Management Act, 2003 (Act 56 of 2003) (MFMA) and the Division of Revenue Act, 2007 (Act No. 1 of 2007) (DoRA). This responsibility includes:
  - designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
  - selecting and applying appropriate accounting policies
  - making accounting estimates that are reasonable in the circumstances.

**Responsibility of the Auditor-General**

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and section 126 of the MFMA, my responsibility is to express an opinion on these financial statements based on my audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008, issued in Government Gazette No. 31057 of 15 May 2008*. Because of the matters discussed in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

**Basis of accounting**

4. The municipality's policy is to prepare financial statements on the entity-specific basis of accounting, as set out in accounting policy note 1.

## **Basis for disclaimer of opinion**

### **Expenditure**

5. Due to a lack of sufficient appropriate audit evidence including contractual agreements in respect of expenditure transactions other than employee costs, I was unable to perform all the audit procedures deemed necessary to confirm the occurrence, accuracy and classification of expenditure amounting to R49 935 701 (2007 - R1 728 032). As a result of the aforementioned I was also not able to confirm the occurrence and accuracy of the conditional grants and subsidies expenditure analysis as disclosed in note 20 to the financial statements. In the absence of adequate supporting documentation, it was not possible to perform alternative procedures.
6. Due to a lack of sufficient appropriate audit evidence in respect of employee and employee-related costs I was not able to perform all the audit procedures deemed necessary to confirm the occurrence, accuracy and correct classification of salaries and wages transactions amounting to R792 751 (2007: R1 339 152). In the absence of adequate supporting documentation, it was also not possible to perform alternative procedures.

### **Creditors**

7. For the reasons as detailed below, I was unable to obtain sufficient appropriate audit evidence to support the completeness, valuation and existence of creditors to the value of R3 556 982, as disclosed on the balance sheet and in note 8 to the financial statements:
  - (a) I was unable to obtain sufficient appropriate audit evidence to support certain creditors with a total value of R992 719 (2007: R1 927 466) included as part of the creditors disclosure. The district municipality also did not have processes in place to ensure regular review and reconciliation of creditors.
  - (b) I was unable to obtain sufficient appropriate supporting documentation in respect of RSC levies paid in advance to the value of R791 536.
  - (c) Creditors as disclosed in note 8 to the financial statements are incorrectly classified in total as trade creditors amounting to R3 556 982 as not all of the balances constitute trade creditors. Creditors comprise of the following individually material classes of balances, deposits R50 923, payments received in advance R791 537, trade creditors R1 385 878 and retention and survey creditors R1 328 644.

Due to the lack of supporting documentation, together with the aforesaid weaknesses in the management processes, there were no alternative procedures that I could perform in respect of the creditor balances.

8. Expenditure was accrued during the financial year ended 30 June 2007 to the amount of R1 142 040 relating to expenditure incurred only in the 2007-08 financial year. Therefore both the comparative figures for creditors and expenditure were overstated by that amount. This also resulted in the understatement of expenditure for the 2007-08 financial year and the overstatement of the accumulated deficit at the beginning of the year.

## **Provisions**

9. The leave records of the district municipality and its records of work attendance were not reliable for purposes of establishing the accuracy and completeness of leave to the credit of officials at year-end. The leave records were therefore not a reliable basis for calculation of the provision for leave as included on the balance sheet and disclosed in note 7 to the financial statements. I was thus unable to obtain sufficient appropriate audit evidence as to the valuation of the provision for leave amounting to R1 733 772 (2007: R2 287 378). In the absence of reliable leave records, it was not possible to perform alternative procedures to accurately determine the value of the provision. This was also reported in the previous financial year.

## **Fixed assets**

10. Weaving plant with a value of R891 928 was not recorded in the fixed asset register and not included in fixed assets as disclosed in note 3 to the financial statements, resulting in an understatement of fixed assets and loans redeemed and other capital receipts.

## **Debtors**

11. I was unable to obtain sufficient appropriate audit evidence as to the valuation and existence of and the municipality's rights to 41 debtor accounts with a value of R799 438 included in the comparative disclosure on the balance sheet and in note 6 to the financial statements. These accounts also remained dormant during the 2006-07 year and, in the absence of adequate supporting evidence, no alternative procedures could be performed to verify these account balances.

## **Retirement benefits**

12. Due to a lack of supporting evidence, the district municipality did not update its disclosure of post-employment benefits at year-end as disclosed in note 22 to the financial statements. The disclosure reflects the situation as at 1 July 2006 and as a result cannot be relied upon to be a fair representation of the district municipality's funding level in terms of the defined benefit pension plans in which it participates. Furthermore, lack of an unfunded liability as stated in the note to the financial statement relates to the entire fund which was attributable to all the municipalities that participated in the fund, and no disclosure was made of the possible apportionment of the funding level attributable to the district municipality.

## **Irregular expenditure**

13. Irregular expenditure is defined in the MFMA as expenditure incurred by the municipality in contravention of or not in accordance with a requirement of this act, and which had not been condoned in terms of section 170; expenditure incurred by a municipality in contravention of or not in accordance with a requirement of the Municipal Systems Act and which had not been condoned in terms of that act; expenditure incurred by the municipality in contravention of or not in accordance with a requirement of the Public Office-Bearers Act, 1998 (Act No. 20 of 1998); or expenditure incurred by a municipality in contravention of or not in accordance with a requirement of the municipality's supply chain management policy or any of the municipality's by-laws giving effect to such policy, and which had not been condoned in terms of such policy or by-law. Irregular expenditure disclosed in note 27 to the financial statements was understated by R18 439 600 due to the following:

- (a) Municipal councillors were remunerated in terms of the prescripts of the upper limits of the annual total remuneration packages of full-time councillors, as published in *Government Gazette No. 29447* issued on 1 December 2006 and *Government Gazette No. 8808* issued on 18 December 2007. The district municipality was incorrectly classified as a grade 5 municipality instead of a grade 4. The incorrect grading of the municipality resulted in the overpayment of councillors to the value of R869 589 for the year under review. As these payments were effected in contravention of the prescripts of the Remuneration of Public Office-Bearers Act, it represents irregular expenditure as defined in section 1 of the MFMA.
- (b) General managers and the junior professional: PIMMS were remunerated on a cost-to-company contractual basis in terms of section 57 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000). This was in contravention of the prescripts of section 57 of the act which clearly states that contract appointments in terms of the act should be made only in respect of municipal managers and managers directly accountable to the municipal manager. Payments amounting to R5 156 578 made to these official are considered to be irregular.
- (c) Section 57(4) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) states that bonuses based on performance may only be awarded to a municipal manager or a manager directly accountable to the municipal manager after the end of a financial year and only after an evaluation of performance and approval of such evaluation by the municipal council concerned. Notwithstanding the prescripts of the act, it was noted that general managers received performance bonuses although they were not managers directly accountable to the municipal manager as stipulated in the act. The bonuses amounting to R2 534 790 and bonuses of the previous financial year paid during the current year amounting to R2 478 617 were thus irregular.
- (d) Expenditure amounting to R1 336 797 was incurred without meeting the procurement requirements as set in the supply chain management policy of the district municipality.
- (e) The requirements of section 67 of the MFMA regarding transfer payments were not adhered to in respect of payments totalling R2 685 140.
- (f) Section 79 of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) determines that only the accounting officer may delegate an official in writing to assist in performing his/her duties. If expenses were not signed by a delegated official, the expenditure incurred by the municipality or municipal entity in contravention of or not in accordance with a requirement of the MFMA could be regarded as irregular. Payments amounting to R3 378 089 were made in contravention of this section.
- (g) In terms of the prescripts of the determination of the upper limits of the annual total remuneration packages of full-time councillors, as promulgated by the Minister of Finance and published in *Notice R.1224 in Government Gazette No. 29447* of 1 December 2006, a municipal council may make a vehicle available to a mayor for use on official business. Section 167(2) of the MFMA states, inter alia, that any other benefit given otherwise than within the framework of the Public Office Bearers Act, is an irregular expenditure and must be recovered. Contrary to the aforementioned prescripts, it was noted that the mayor of the municipality utilises the municipality's official vehicle for private travel to and from her home in Botshabelo. The estimated cost of the private use that is recoverable in terms of the MFMA amounts to R288 544.

### **Fruitless and wasteful expenditure**

14. Fruitless and wasteful expenditure is defined in the MFMA as expenditure that was made in vain and would have been avoided had reasonable care been exercised. The municipality incurred fruitless and wasteful expenditure as detailed below amounting to R1 357 557 and this expenditure was not disclosed in note 28 to the financial statements.
- (a) Seven drivers/security guards were appointed for the mayoral office although the establishment only allows for two drivers. The salaries of the five additional drivers/security guards amounting to R977 134 amounted to fruitless expenditure.
  - (b) Rental was paid for storage space not optimally utilised and for the storage of the above weaving machine, amounting to R103 157.
  - (c) Accommodation for additional nights was paid by the municipality for an overseas trip to the value of R52 870 which could have been avoided.
  - (d) Vehicle hire amounting to R87 044 was paid by the municipality although this was not permitted in terms of the districts municipality's policy.
  - (e) Charges for repairs done to the mayor's office were considered excessive to an amount of R11 857, if compared to market-related prices for the supplies and kilometre tariffs charged for the renovations.
  - (f) Air-conditioners were fitted to a rental property at a cost for the municipality. Taking the remaining rental period and the depreciation on air-conditioners into account, fruitless expenditure of R79 297 was incurred by the municipality as air-conditioners are considered fixtures and cannot be removed on expiry of the rental contract.
  - (g) Fuel amounting to R18 390 was purchased on the municipality's account for vehicles not registered in the municipality's name. These expenses were not followed up or recovered from the relevant officials.
  - (h) New vehicle rims were purchased for the mayoral vehicle at a cost of R12 798 without obtaining an accident report or proof of damage to the old rims.
  - (i) Subsistence allowances were paid in excess of the amounts permitted according to the policy of the municipality, amounting to R15 010.

### **Disclaimer of opinion**

Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have been unable to obtain sufficient appropriate audit evidence to provide a basis for an opinion on the financial statements of Motheo District Municipality. Accordingly, I do not express an opinion on the financial statements.

## Emphasis of matter

15. I draw attention to the following matters:

### Unauthorised expenditure

16. As indicated in note 26 to the financial statements, the district municipality had incurred unauthorised expenditure totalling R3 603 440 in the current and previous financial years.

### Irregular expenditure

17. As indicated in note 27 to the financial statements, the district municipality had incurred irregular expenditure totalling R21 104 565 in the previous financial years.

### Fruitless and wasteful expenditure

18. As indicated in note 28 to the financial statements, the district municipality had incurred fruitless and wasteful expenditure totalling R1 280 963 in the previous financial years.

## OTHER MATTERS

I draw attention to the following matters that are ancillary to my responsibilities in the audit of the financial statements:

### Internal control

19. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial risk management and internal control. The table below depicts the root causes that gave rise to the inefficiencies in the system of internal control, which led to the disclaimer of opinion. The root causes are categorised according to the five components of an effective system of internal control. In some instances deficiencies exists in more than one internal control component.

Reporting item	Control environment	Assessment of risks	Control activities	Information and communication	Monitoring
<b>Basis for disclaimer of opinion</b>					
Expenditure	X	X	X		
Creditors	X	X	X		
Provisions	X	X	X		
Fixed assets	X	X	X		
Debtors	X	X	X		
Retirement benefits		X	X		X
Irregular expenditure	X	X	X		
Fruitless and wasteful expenditure	X	X	X		
<b>Control environment:</b> establishes the foundation to the internal control system by providing fundamental discipline and structure for financial reporting					
<b>Risk assessment:</b> involves the identification and analysis by management of relevant financial reporting risks to achieve predetermined financial reporting objectives.					



**Control activities:** policies, procedures and practices that ensure that management's financial reporting objectives are achieved and financial reporting risk mitigation strategies are carried out.

**Information and communication:** supports all other control components by communicating control responsibilities for financial reporting to employees and by providing financial reporting information in a form and time frame that allow people to carry out their financial reporting duties.

**Monitoring:** covers external oversight and internal control over financial reporting by management or other parties outside the process; or the application of independent methodologies, like customised procedures or standard checklists, by employees within the process.

## **Non-compliance with applicable legislation**

### **Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA)**

20. Contrary to the prescripts of section 18(2) of the MFMA, the municipality did not submit a realistic revenue budget for the year as R7 704 027 of the revenue that was budgeted did not materialise.
21. Contrary to the prescripts of section 53(1)(c)(iii) of the MFMA, no proof could be provided that the mayor took all reasonable steps to ensure that the annual performance agreements with employees were signed, as required by section 57(1)(b) of the Systems Act, because management could not provide me with any performance agreements relating to the 2007-08 financial year. I could therefore not determine whether all requirements of the MFMA and Systems Act were taken into consideration.
22. Contrary to the prescripts of section 65(2) of the MFMA, numerous instances were identified where suppliers were not paid within 30 days and no proof could be obtained of any measures implemented to track the submission and payment of invoices to ensure compliance with this section of the MFMA.

### **Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA)**

23. Contrary to the prescripts in section 96 of the MSA, I noted that the district municipality did not have a proper debt collection policy in place to ensure that all monies due to it were collected. From work done under the debtors' component, various instances were identified where debtors showed no movement during the year.
24. Contrary to the prescripts of section 40 of the MSA, I was unable to obtain evidence that the municipality had established mechanisms to monitor and review its performance management system.

## Matters of governance

25. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of certain key governance responsibilities, which I have assessed as follows:

Matter of governance	Yes	No
<b>Audit committee</b>		
• The municipality had an audit committee in operation throughout the financial year.		X
• The audit committee operates in accordance with approved, written terms of reference.		X
• The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.		X
<b>Internal audit</b>		
• The municipality had an internal audit function in operation throughout the financial year.		X
• The internal audit function operates in terms of an approved internal audit plan.		X
• The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA.		X
<b>Other matters of governance</b>		
• The annual financial statements were submitted for audit as per the legislated deadlines in section 126 of the MFMA.	X	
• The annual report was submitted to the auditor for consideration prior to the date of the auditor's report.	X	
• The financial statements submitted for audit were not subject to any material amendments resulting from the audit.		X
• No significant difficulties were experienced during the audit concerning delays or the unavailability of expected information and/or the unavailability of senior management.		X
• The prior year's external audit recommendations have been substantially implemented.		X
• The Provincial SCOPA resolutions have been substantially implemented.		X
<b>Implementation of Standards of Generally Recognised Accounting Practice (GRAP)</b>		
• The municipality submitted an implementation plan, detailing progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 30 October 2007.		X
• The municipality substantially complied with the implementation plan it submitted to the National Treasury and the relevant provincial treasury before 30 October 2007, detailing its progress towards full compliance with GRAP.		X
• The municipality submitted an implementation plan, detailing further progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 31 March 2008.		X



## **Unaudited supplementary appendixes**

26. The supplementary appendixes set out on pages X to X do not form part of the financial statements and are presented as additional information. I have not audited this and accordingly I do not express an opinion thereon.

## **OTHER REPORTING RESPONSIBILITIES**

### **Reporting on performance information**

27. I have audited the performance information as set out on pages xx to xx.

### **Responsibility of the accounting authority for the performance information**

28. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

### **Responsibility of the Auditor-General**

29. I conducted my engagement in accordance with section 13 of the PAA, read with *General Notice 616 of 2008*, issued in *Government Gazette No.31057 of 15 May 2008* and section 45 of the MSA.
30. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.
31. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

## **Audit findings**

### **Internal auditing of performance measurements**

32. The district municipality did not develop and implement mechanisms, systems and processes for auditing the results of performance measurement as part of its internal audit processes, as required in terms of section 45 of the MSA.

### **Lack of system generating performance information**

33. I was unable to obtain sufficient appropriate audit evidence in relation to the performance information of the Motheo District Municipality, as the system used for generating information on the target of buckets eradicated and sewerage connections was not adequate for purposes of the evaluation.

### **Content of integrated development plan**

34. The key performance indicators set by the Motheo District Municipality did not include all the general key performance indicators applicable to the municipality, as prescribed in terms of section 43(1) of the MSA.

## OTHER REPORTS

### Investigations

35. An investigation is being conducted by the Special Investigation Unit into certain infrastructure projects at the municipality and was still in progress at the reporting date.

## APPRECIATION

36. The assistance rendered by the staff of Motheo District Municipality during the audit is sincerely appreciated.

*Auditor-General*

Bloemfontein

30 November 2008



A U D I T O R - G E N E R A L